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VALUATION OF SHARES BASED ON THE COST APPROACH

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Abstract
The article considers the valuation of shares based on the cost approach. The cost approach to valuing shares is based on the assertion that the cost of securities is comparable to the costs that must be incurred to create a similar company. The cost of shares in this case is equated to the market value of the replaced enterprise. The advantages and disadvantages of the cost approach are given. The main methods of the cost approach to business valuation are highlighted. Their strengths and weaknesses of the cost approach to business valuation are determined.

Keywords: Valuation, value, investments, methods, assets, shares, cost approach

Introduction

The very concept of business valuation reveals the relevance of the topic - the calculation and justification of the value of a business on a certain date, which is a targeted, orderly process of determining the value of an object in monetary terms, taking into account the factors influencing it at a specific point in time in a specific market. The results of business valuation obtained on the basis of the analysis of external and internal sources of information are necessary both for conducting negotiations on the purchase and sale, and for choosing a business development strategy, its economic security. In the process of strategic planning, it is important to assess the future income of the business, the degree of its stability, the value of the image. It is necessary to have information on the value of part of the assets or the entire business to justify investment projects for

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business development. Business valuation is usually carried out using three approaches, namely, income, cost and comparative [2].

When determining the market value of a business, the cost approach is represented by the net asset value method. A business that has a significant property complex and has significant capital investments in buildings, structures, equipment, is better off using the cost approach to valuing the business. The undoubted advantage of the cost approach to business valuation is that it is based on the real valuation of existing business assets, most of which, as a rule, are equity. The cost approach to business valuation is indispensable for valuing objects that are unique in their type and purpose, for which there is no market, or for objects with insignificant depreciation. The disadvantage of the cost approach is the impossibility of taking into account future cash receipts and the level of return on existing assets. Therefore, the cost approach to business valuation, as a rule, determines the upper limit of the estimated business value [1]. Book value rarely adequately reflects the value of net assets. However, the balance sheet provides information on a certain date on the types and amounts of assets used by the business (invested funds) and their compensating obligations to creditors and owners (received funds), which is why it is the starting point for asset-based business valuation [4]. Table 1 highlights the positive and negative aspects of the cost approach to business valuation.

Table 1. Positive and negative aspects of the cost approach to business valuation

	Brief description	***Advantages***	***Disadvantages***
Cost approach to business valuation	It is based on the real value assessment of the existing assets of the business, the majority of which, as a rule, are equity capital.	Indispensable for assessing objects that are unique in their type and purpose, for which there is no market, or for objects with minor wear	The inability to take into account future cash flows and the level of return on existing assets. And therefore, the cost approach to business valuation, as a rule, determines the upper limit of the estimated business value

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The procedure for determining the value of a business based on assets usually includes the following steps (Fig. 1): preparation of the balance sheet as of the valuation date, valuation of tangible property (namely, real estate, machinery, equipment) at market value, detection and valuation of intangible assets, conversion of financial assets to net realizable value, conversion of liabilities to current value, making accounting adjustments and preparing an adjusted balance sheet, determining the value of equity as the difference between the total value of assets and the current value of business liabilities [4].

The cost approach to business valuation is based on the principle of replacement. According to this principle, it is assumed that an informed investor will never pay more for an object than the cost of reproducing a similar object of equal utility [1]. When valuing machinery, equipment and vehicles, the use of the cost approach consists of calculating the costs of reproducing or replacing an exact copy of the object being valued or an object similar to the object being valued, minus losses in value from all types of depreciation, impairment and obsolescence [5].

To determine the market or other value of the object of assessment of machinery, equipment and/or vehicles, the initial basis is the full cost of reproduction or replacement cost.

The composition of the full cost of reproduction is presented in Fig. 2 and includes the costs of reproduction (replacement) of the object or the selling price of the manufacturer, transportation costs for delivery of equipment to the place of use, including loading and unloading, the cost of rigging, the cost of installation and assembly, including the construction of the foundation, connection to utilities, indirect costs and fees, payments and taxes [3]. Presents groups of methods of the cost approach [1-5]:

1) methods based on methods of direct determination of costs are used to assess the cost of special and specialized machines and equipment;

2) methods based on indirect cost determination methods are used to assess the cost of universal machines and equipment, as well as specialized equipment manufactured on the basis of universal ones.

The following features should be highlighted when determining depreciation, namely. To determine the accumulated depreciation of equipment, the cost

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method involves determining three types of depreciation: physical, functional, external environment, which in value form will be deducted from the cost of a new object.

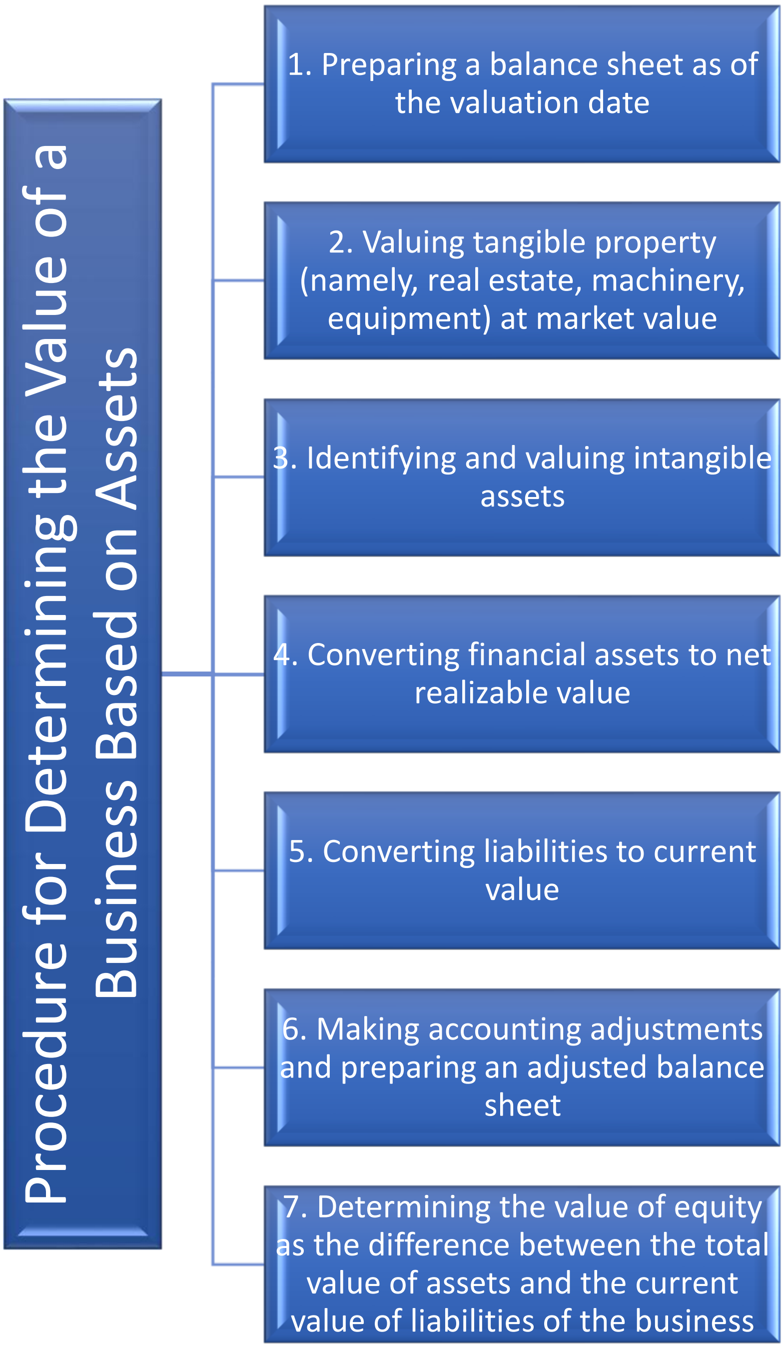

Fig. 1. The procedure for determining the value ofa business based on assets

To determine physical depreciation, take into account that physical depreciation is a loss of value due to natural processes during operation. Physical depreciation is expressed in aging and wear, destruction, rotting, rusting, breakage and design defects. Physical depreciation of movable property can be determined by the effective age method (or service life method) or by the expert method. As part of the assessment, an expert method can be used to determine physical depreciation using a scale of expert values. To determine functional wear and tear, take into account that functional wear and tear (functional obsolescence) is a loss of value due to the relative inability of an object to provide utility compared to a new, similar, more modern object created for the same purposes. It is usually caused by the emergence of new technologies, non-compliance with technical and functional requirements for such parameters as size, service life, energy intensity, ergonomics, power, etc. Thus, functional wear and tear, or functional obsolescence, is caused by non-compliance with modern standards [3].

External (economic) wear and tear is a loss of value caused by the influence of external factors. External wear and tear can be caused by a number of reasons. First of all, such as general economic or intra-industry changes, including a decrease in demand for a certain type of product and a decrease in supply or deterioration in the quality of raw materials, labor, auxiliary systems, structures and communications; as well as legal changes related to legislation, municipal regulations, zoning and administrative orders [4]. The cost approach to business valuation is indispensable for valuing objects that are unique in their type and purpose, for which there is no market, or for objects with minor depreciation. The disadvantage of the cost approach is the impossibility of taking into account future cash receipts, the level of return on existing assets. Therefore, the cost approach to business valuation, as a rule, determines the upper limit of the estimated business value [1]. Book value rarely adequately reflects the value of net assets. However, the balance sheet provides information on a certain date on the types and sizes of assets used by the business (invested funds) and their compensating obligations to creditors and owners (received funds), which is why it is the starting point for asset-based business valuation [2].

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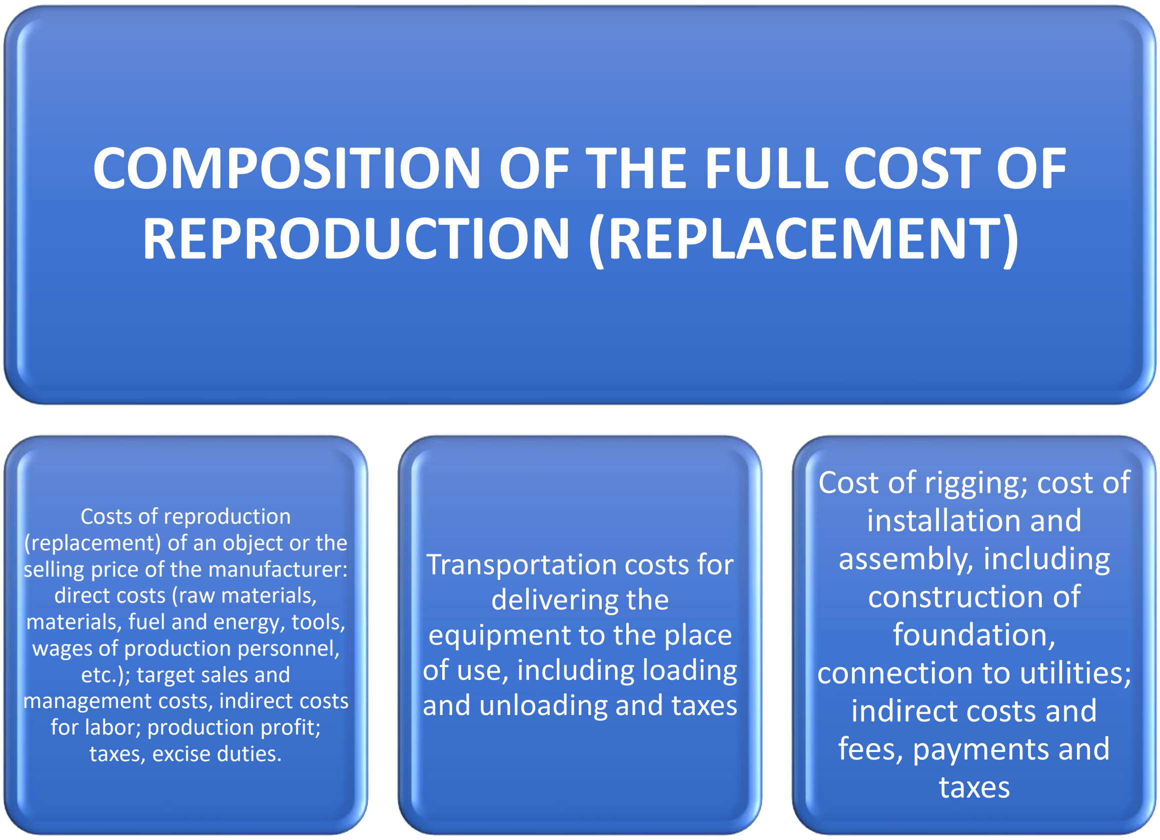

Fig. 2. Composition of the total cost of reproduction of an object

Based on the given methodology of the cost approach to business valuation, it is impossible to calculate the market value of the assessed object, which is explained by the lack of information on the cost of the property, the manufacturer's profit, taxes and excises, indirect costs, transportation costs. Especially if the assessed property does not consist of separate finished units and blocks, and is a single product of complex technological production. In such cases, the cost approach to property valuation cannot be applied.

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